Supreme Court, U.S.
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IN THE

Supreme Court of the United States

NATIONAL HERITAGE INSURANCE COMPANY,

Petitioner,

v.

UNITED STATES EX REL. TONI R. BARRON AND VICKY SCHEEL,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

I. Whether the Fifth Circuit erred by applying a test designed to determine a *public* entity's "arm of the state" immunity to a *private* corporate entity, thereby widening a circuit split that now includes the Fifth, Ninth, and Eleventh Circuits.

II. Whether the Fifth Circuit erred by establishing a state treasury test that conflicts with this Court's precedent and with decisions of the Fourth and Eleventh Circuits.

INTERESTED PARTIES AND 29.6 STATEMENT

The following listed persons and entities have an interest in the outcome of this case.

Defendant-Petitioner

National Heritage Insurance Company (wholly owned by Electronic Data Systems Corporation, a public corporation traded on the New York Stock Exchange)

Relators-Respondents

Toni R. Barron
Vicky Scheel

United States-Respondent

Paul D. Clement

Defendants-Respondents

Deloitte & Touche, L.L.P.
Deloitte & Touche Consulting Group, L.L.C.
Deloitte & Touche Consulting Group Holding, L.L.C.

Defendant-Respondent

Medicaid Claim Solutions of Texas

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Petitioner, National Heritage Insurance Corporation ("NHIC") respectfully prays that a writ of certiorari issue to review the opinion of the United States Court of Appeals for the Fifth Circuit, entered in the above-entitled proceeding on August 11, 2004.

OPINIONS BELOW

The opinion of the Fifth Circuit is reported at 381 F.3d 438 and is reproduced in the appendix hereto. (Appendix A) (hereinafter "App."). The decision of the District Court and the Findings and Recommendations of the Magistrate Judge are unreported and are reprinted in the appendix. (App. B and C, respectively). The order of the Fifth Circuit denying NHIC's petition for *en banc* or panel rehearing is reprinted in the appendix. (App.. D).

STATEMENT OF JURISDICTION

The opinion of the court of appeals was entered on August 11, 2004. Petitioner timely sought panel or *en banc* rehearing, which the Fifth Circuit denied on December 9, 2004. (App. D). The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

CONSTITUTIONAL PROVISION INVOLVED

U.S. Constitution, Amendment 11:

> The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State.

STATEMENT OF THE CASE

This Petition presents an important issue of first impression to this Court, over which the federal courts of appeals are divided: when does a private corporation acting on behalf of a state become "an arm of the state" for Eleventh Amendment immunity purposes? The Petition also urges review of a novel test adopted by the Fifth Circuit that all but requires that the state itself be directly liable for a judgment before the "effect on a state's treasury" is deemed sufficient to warrant a grant of Eleventh Amendment immunity to a private corporate entity. The Fifth Circuit's new test conflicts with precedent of this Court as well as decisions of the courts of appeals for the Fourth and Eleventh Circuits.

Respondents Toni R. Barron and Vicky Scheel ("Relators"), filed this *qui tam* action under the False Claims Act, 28 U.S.C. § 3729 *et seq.* ("FCA"), against NHIC, Deloitte & Touche, L.L.P, Deloitte & Touche Consulting Group, LLC, Deloitte & Touche Consulting Group Holding, LLC ("Deloitte"), and Medicaid Claim Solutions of Texas. Relators' claims arise out of the School Health and Related Services ("SHARS") program in Texas, which is part of the Medicaid Program operated by the State of Texas (the "Texas Medicaid Program"). The Relators are therapists who purportedly worked with students receiving services from the SHARS program. (Record at 4, 535) (hereinafter referred to as "R."). Their suit claims that, in the course of providing SHARS services, Deloitte and Medicaid Claim Solutions were enlisting SHARS providers to improperly bill services to the SHARS program. (R. at 1-23, 532-82).

NHIC was sued solely in its capacity as the claims administrator for the Texas Medicaid Program. Texas law allows the Texas Department of Human Services to use "any fiscal intermediary" to pay claims made under the Texas Medicaid Program. *See* TEX. HUM. RES. CODE ANN. § 32.029(b) (Vernon 1997). In this statutory role, NHIC processes and pays Medicaid claims on behalf of the State of Texas in accordance with explicit rules and regulations promulgated by the State and federal government that leaves nothing to NHIC's discretion. (R. at 183). NHIC's role with respect to the SHARS Program is to pay claims for services rendered to students by eligible providers pursuant to guidelines and rates set by the State. The providers, not NHIC, certify that they have complied with all of the requirements of the SHARS program when they request payment.

It is undisputed that NHIC does not set Medicaid rates or establish any of the rules or regulations governing the SHARS Program, and that at all times material to Relators' claims, NHIC was acting under the direction and supervision of the State agencies that regulate the SHARS Program. (R. at 182-83). Nor is there any allegation in Relators' complaint that NHIC acted in contravention of any policies, procedures, or directions issued by the State of Texas with respect to the operation of the SHARS Program. (R. at 183, 409-17). In fact, Relators' first Complaint repeatedly referred to NHIC and the State of Texas collectively. (Respondents' Record Excerpts Tab 6).

NHIC moved to be dismissed from Relators' lawsuit on immunity grounds. On March 31, 2003, the District Court adopted the findings and recommendations of the Magistrate Judge dismissing Relators' case in its entirety. (App. at 16a-17a). In his findings and recommendations, the Magistrate

Judge ruled that NHIC was entitled to Eleventh Amendment immunity as an arm of the State of Texas. (App. at 45a-53a). The Magistrate Judge reached this conclusion based on NHIC's relationship with the State of Texas and the Texas Medicaid Program, focusing on the following determinative facts:

(1) NHIC derived its authority to act from the Texas Human Resources Code and its services contract with the State of Texas;

(2) a judgment against NHIC for services performed in its role as a Medicaid fiscal intermediary would affect the treasury of the State of Texas;

(3) the conduct of NHIC was controlled by the State of Texas, and NHIC "does not exercise any autonomy or discretion of its own in [the distribution of Medicaid funds];" and

(4) NHIC performed its services for the benefit of the whole State of Texas.

(App. at 48a-52a).

Relators subsequently appealed the District Court's order and judgment adopting the Magistrate Judge's report and recommendation. On appeal, the Fifth Circuit reversed the District Court's judgment, holding that because the State of Texas was not a named party in the litigation and the State of Texas would not be required to indemnify NHIC for any judgment against it, the state treasury was not sufficiently affected to warrant a finding that NHIC was an arm of the State of Texas. (App. at 3a-5a).

REASONS FOR GRANTING THE PETITION

Medicaid is a $300 billion a year program that involves tens of thousands of service providers and serves roughly 50 million people.[1] Few if any states have the administrative skill or resources to operate this important program without assistance, so they delegate their state functions and authority to private companies to be exercised pursuant to explicit state guidelines. But as states increasingly turn some of their duties and obligations (like Medicaid) over to private companies, one important aspect of that relationship is more uncertain than ever: When does a corporate entity implementing the state's programs enjoy the immunity of the state?

Almost thirty years ago, this Court held that a *public* entity which qualified as an arm of the state could "partak[e] of the State's Eleventh Amendment immunity." *Mt. Healthy City Sch. Dist. Bd. of Educ. v. Doyle*, 429 U.S. 274, 281 (1977). With additional guidance from such cases as *Regents of the University of California v. Doe*, 519 U.S. 425, 429-30 (1997)[2], the courts of appeals have attempted to develop

1. *See, e.g.*, Bret Schulte, *Taking on a Budget-Busting Mess*, U.S. News & World Report, Feb. 21, 2005, at 38.

2. *Regents* noted that the Court "sometimes examined 'the essential nature and effect of the proceeding,' . . . and sometimes focused on the 'nature of the entity created by state law' to determine whether it should 'be treated as an arm of the State.'" *Regents of the Univ. of Cal. v. Doe*, 519 U.S. 425, 429-30 (1997) (internal citations omitted). Additionally, in *Regents*, the Court said that "the question of whether a money judgment against a state instrumentality or official would be enforceable against the State is of considerable importance to any evaluation of the relationship between the State and the entity or individual being sued." *Id.* at 430 (citing *Hess v. Port Auth. Trans-Hudson Corp.*, 513 U.S. 30, 45-51 (1994)).

similar approaches for determining the right of a *public* entity to invoke a state's Eleventh Amendment immunity.[3]

But in the context of a *private* corporate entity, a multi-circuit conflict exists with respect to the proper test that should be used to determine when the private entity is entitled to invoke the State's Eleventh Amendment immunity. *Compare United States ex rel. Barron v. Deloitte & Touche*, (App. A), 381 F.3d 438 (5thCir. 2004), and *United States ex rel. Ali v. Daniel, Mann, Johnson & Mendenhall*, 355 F.3d 1140, 1147 (9th Cir. 2004), *with Shands Teaching Hosp. and Clinics, Inc. v. Beech St. Corp.*, 208 F.3d 1308 (11th Cir. 2000). This Court has never addressed that specific question. As a result, conflict prevails among the decisions of the courts of appeals. The Fifth and the Ninth Circuits squarely conflict with the Eleventh Circuit's position on this important constitutional question.

The uncertainty and confusion surrounding the correct approach for determining whether and when a private corporate entity may invoke a state's Eleventh Amendment immunity places considerable strain on states and their current and would-be corporate agents. Who, if anyone, bears

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3. *See, e.g., Clissuras v. City Univ. of New York*, 359 F.3d 79, 82 (2d Cir. 2004) (two-factor test) (citing *Pikulin v. City Univ. of New York*, 176 F.3d 598, 600 (2d Cir. 1999)); *Vierling v. Celebrity Cruises, Inc.*, 339 F.3d 1309 (11th Cir. 2003) (three-factor test); *Wojcik v. Massachusetts State Lottery Comm'n*, 300 F.3d 92 (1st Cir. 2002) (seven-factor test); *Clark v. Tarrant County*, 798 F.2d 736 (5th Cir. 1986) (six-factor test). Although these tests generally attempt to incorporate similar factors, such as the source of the entity's funding, whether state law views the entity as an arm of the state or not, and the degree of control exercised by the state over the entity, the actual tests applied by many of the courts of appeal in practice are quite different. *See* Sections I & II, *infra.*

risk of suit, what principles govern the analysis, how should the contract be structured to utilize the principles, and how can any such risk be allocated? In this unsettled context, what kind of premium must a state pay in order to attract potential Medicaid administrators to the table, and how does that affect the administration of Medicaid? Given the extant conflicts, will corporate agents do business with states in some circuits but not in others? The answers profoundly affect the way states and their corporate agents administer Medicaid and other state and federal programs. This Court can and should issue a writ of certiorari to review the opinion of the Fifth Circuit and provide the guidance that is greatly needed in this important area of the law.

I. A Direct Conflict Exists in the Circuit Courts Regarding the Proper Test to Determine Whether a Private Entity is Entitled to Eleventh Amendment Immunity as an "Arm of the State."

In this case, the Fifth Circuit applied its six-factor *public* entity test to determine whether NHIC, a *private* corporate entity, was an arm of the state. The factors applied below were: (1) whether the state statutes and case law view the entity as an arm of the state; (2) the source of the entity's funding; (3) the entity's degree of local autonomy; (4) whether the entity is concerned primarily with local, as opposed to statewide, problems; (5) whether the entity has the authority to sue and be sued in its own name; and (6) whether the entity has the right to hold and use property. *See Barron*, (App. at 3a), 381 F.3d at 440 (citing *Hudson v. City of New Orleans*, 174 F.3d 677, 679 (5th Cir. 1999)). The Ninth Circuit also has applied its public entity arm of the state inquiry to determine whether a private corporation is an arm of the state for Eleventh Amendment immunity purposes. *See Ali*, 355 F.3d at 1147.

The Eleventh Circuit, on the other hand, has expressly refused to apply its public entity analysis to private corporate entities. *See Shands*, 208 F.3d 1308.[4] *Shands* involved a suit brought by a hospital network that provided medical services to employees of the State of Florida under the State's self-funded health benefits plan against two private corporations – one that contracted with the State of Florida to act as a third party administrator of the State's self-funded employee health benefits plan, and another that worked for the third party administrator as a subcontractor. *See id.* at 1309-10. The plaintiff argued that the corporations did not qualify as arms of the State because they were not directly controlled by the State and did not derive their funding from the State. *See id.* at 1311.

The Eleventh Circuit concluded that the plaintiff's argument "misse[d] the mark." The proper inquiry, the court held, was not into "the nature of a corporation's status in the abstract, but its function or role in a particular context." *Id.* Thus, the court held that the outcome of the case depended on whether and to what extent the private corporations were contractually acting as representatives of the State, and that

> the dispositive question for Eleventh Amendment purposes is whether a judgment against [the defendants] would implicate the state treasury *or* interfere with the administration of the state group insurance program, or whether the claims constitute a private cause of action, arising out of tort or contract, for which [the defendants] would be financially responsible.

Id. (emphasis added).

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4. The fact that the *Shands* court applied a different test to a private entity is highlighted by the fact that the court continues to apply its traditional multi-factor test to *public* entities. *See Vierling*, 339 F.3d at 1314 (holding that the traditional multi-factor arm of the state test is applied to determine whether a state agency or instrumentality may invoke the state's immunity).

It is far more logical to apply the *Shands* test to a private corporate entity than to apply the public entity test used by the Fifth Circuit in the case below. As the Fifth Circuit itself acknowledged, at least two of the six public entity factors are difficult if not impossible to evaluate in the context of a private corporation, *Barron*, (App. at 6a-7a), 381 F.3d at 441-42 ("the entity's degree of local autonomy" and "the entity's concern with local, as opposed to statewide, problems"), while two others – the authority to sue and be sued and the ability to hold and use property – are largely meaningless to the inquiry because *every* private corporation presumably will have such authority. It was this difficulty which led the Eleventh Circuit in *Shands* to state that "the pertinent inquiry is not into the nature of a corporation's status in the abstract, but its function or role in a particular context." *Shands*, 208 F.3d at 1311.

Forcing the public entity framework on private corporate entities, as the Fifth Circuit did, conflicts with the Eleventh Circuit's more pragmatic and realistic approach. The difference is not theoretical. NHIC plainly would have enjoyed Eleventh Amendment immunity as an arm of the state in the Eleventh Circuit, yet it is has no such immunity in the Fifth Circuit.

Imposing the public entity analytical framework in the context of a private corporate entity hardly provides any clarity, and, in fact, only entrenches existing circuit conflicts. The Fifth Circuit and other courts disagree both as to the factors to apply to an entity asserting arm of the state immunity as well as to the relative importance of those factors.

This Court's decisions in *Hess v. Port Authority Trans-Hudson Corp.*, 513 U.S. 30 (1994), and *Regents of the University of California* attempted to clarify this area of the law, but the law is still quite fractured. In *Regents of the University of California*, the Court stated that "the question of whether a money judgment against a state instrumentality or official would be enforceable against the State is of considerable importance to any evaluation of the relationship between the State and the entity or individual being sued." *Regents*, 429 U.S. at 430. *Regents* followed, and affirmed, the Court's holding in *Hess* that "the vulnerability of the State's purse [is] the most salient factor in Eleventh Amendment determinations." *Hess*, 513 U.S. at 48. As noted by the Sixth Circuit, the collective result of these two cases is that "the *Hess* opinion focused on the impact on a state treasury, and [*Regents v.*] *Doe* slightly altered that emphasis by establishing that *potential liability, not actual ability to pay or indemnification*, determines the Eleventh Amendment status of an entity." *Brotherton v. Cleveland*, 173 F.3d 552, 560-61 (6th Cir. 1999) (emphasis added).

While the Sixth Circuit emphasized the Supreme Court's focus on issues which impact the state treasury, the Fourth Circuit found *Regents'* language concerning an entity's treatment by state law to be significant as well. *See Cash v. Granville County Bd. of Educ.*, 242 F.3d 219 (4th Cir. 2001). In *Cash*, the court held that an entity could enjoy Eleventh Amendment immunity as an arm of the state even where the state treasury would not be affected by an adverse judgment when "the judgment would adversely affect the dignity of the State as a soverign and as one of the United States. . . . Under this inquiry, factors formed largely to determine the 'relationship between the State and the entity in question' . . . become relevant." *Id.* at 224 (*quoting Regents*, 519 U.S. at 429).

Here, the Fifth Circuit purported to analyze NHIC's status under the traditional six-factor public entity analysis. But as the language of the opinion makes clear, the court ultimately relied on one – and only one—factor in reaching the decision that "the source of the entity's funding . . . is the weightiest factor, and *it is controlling here*." *Barron*, (App. at 3a), 381 F.3d at 440 (emphasis added). The court's admission that this so-called "state treasury" factor controlled its analysis underscores the conflict in the courts of appeals with respect to the tests properly used to determine whether a private entity is entitled to invoke a state's Eleventh Amendment immunity.

Recent decisions of the Sixth and Fourth Circuits provide an excellent illustration of the present conflict that exists between the circuits. In *Ernst v. Roberts*, 379 F.3d 373, 382 (6th Cir. 2004), *reh'g granted* (Nov. 17, 2004)[5], the court discussed the collective result of its arm of the state rulings since *Hess* and *Regents*, reaching the following conclusion:

> [i]n light of the statements [in the Sixth Circuit's recent arm of the state cases] indicating that *Hess* may have completely eliminated any consideration of other factors, we reiterate the position taken in those cases: potential liability of the state treasury is the most important factor, and the other factors may have been rendered completely obsolete by Hess.

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5. Although the Sixth Circuit has decided to rehear this case *en banc*, NHIC cites the opinion only for the purposes of discussing the summary of the circuit's law as explained in the opinion. The fact that the court has decided to rehear the case *en banc* demonstrates the uncertainty of arm of the state jurisprudence even within individual circuits, let alone between the circuits.

The Sixth Circuit acknowledged that when the parties present no evidence on the state treasury factor, "other factors may be considered." *Id.* Nevertheless, the court reiterated its holding, noting that "it is unclear whether other factors may even be considered when evidence is presented regarding whether the state treasury will be liable for a judgment." *Id.*

The Fourth Circuit employs a test dramatically different from the Fifth and Sixth Circuits in determining whether an entity is entitled to immunity as an arm of the state. To be sure, the Fourth Circuit places emphasis on the state treasury factor, holding that "if the State treasury will be called upon to pay the judgment against a government entity, then Eleventh Amendment immunity applies to that entity, and consideration of any other factor becomes unnecessary." *Cash*, 242 F.3d at 223.

But the converse is not true. The court explicitly held that when the state treasury will not be affected by a judgment, "the entity may still enjoy sovereign immunity if the judgment would adversely affect the dignity of the State as a sovereign and as one of the Untied States." *Id.* at 224. In order to determine whether an entity is an arm of the state under this additional "state dignity" analysis, the Fourth Circuit looks to three additional factors: (1) the degree of control that the state exercises over the entity or the degree of autonomy from the state enjoyed by the entity; (2) whether the entity is concerned with matters on a state or local scale; and (3) the manner in which state law treats the entity. *See id.* It is obvious that the Fifth Circuit's test could not be more divergent from the one employed by the Fourth Circuit, and that this conflict directly affects NHIC's ability to invoke Eleventh Amendment immunity.

Other circuit courts have developed additional variations of the arm of the state inquiry. The Second Circuit, for example, has held that six factors are to be considered in determining whether an entity is an arm of the state: (1) how the entity is referred to in its documents of origin; (2) how the entity's governing members are appointed; (3) how the entity is funded; (4) whether the entity's function is concerned with state or local governmental matters; (5) whether the state has veto power over the entity's actions; and (6) whether the entity's fiscal obligations are binding upon the state. *See McGinty v. New York*, 251 F.3d 84, 95 (2d Cir. 2001). The court stated that

> [i]f these factors point in one direction, the inquiry is complete. If not, a court must ask whether a suit against the entity in federal court would threaten the integrity of the state and expose its treasury to risk. If the answer is still in doubt, a concern for the state fisc will control.

Id. at 96 (internal citations omitted).

The test applied by the Tenth Circuit is a two-part inquiry resembling that of the Second Circuit. *First*, the court examines the degree of autonomy enjoyed by the entity, "as determined by the characterization of the agency by state law and the extent of guidance and control exercised by the state. *Second*, the court examines the extent of financing the agency receives independent of the state treasury and its ability to provide for its own financing." *Sturdevant v. Paulsen*, 218 F.3d 1160, 1164 (10th Cir. 2000). "The ... entity is immune from suit if the money judgment sought is to be satisfied out of the state treasury." *Id.*

Collectively, these tests demonstrate that, from circuit to circuit, an entity may face markedly different requirements to invoke arm of the state immunity. There is no doubt that the tests of the circuit courts, including those applied by the Fifth Circuit in this case and the Eleventh Circuit in *Shands*, are in direct conflict. This conflict alone merits the issuance of writ of certiorari to resolve this vital constitutional issue.

II. The Novel Test Developed by the Fifth Circuit to Determine When a Judgment Impacts the State Treasury for Eleventh Amendment Purposes Conflicts with Decisions both of this Court and Other Circuit Courts.

The inapplicability of the Fifth Circuit's multi-factor public entity test to NHIC forced the court to, in effect, create a one-factor test for corporate entities.[6] The court held that the indemnity clause[7] between NHIC and the State of Texas, which obligated NHIC to pay any judgments assessed against the State resulting from NHIC's performance, "conclusively establishes that Texas will suffer *no legal liability* for any

6. While the Fifth Circuit purported to make the "source of the entity's funding" the dispositive question, *Barron*, (App. at 3a), 381 F.3d at 440 ("the source of the entity's funding . . . is the weightiest factor, and it is controlling here."), the court actually created a novel, and very narrow, indemnity test. Indeed, had the court actually analyzed the *source* of NHIC's funding it would have found that NHIC exists solely to administer Medicaid and Medicare programs, and that it is funded solely by Medicaid and Medicare funds.

7. Without discussing the merits of the Fifth Circuit's holding as to the meaning of the indemnity clause, NHIC notes that it does not agree with the Fifth Circuit's interpretation of the clause, and no statement in this Petition is intended to constitute a waiver of NHIC's position with respect to the meaning of that clause.

damages assessed against NHIC." *Barron*, (App. at 4a), 381 F.3d at 440 n.7. The court went on to state that its "inquiry about a judgment's effect on state treasuries does not extend to suppositions about whether NHIC will . . . pay its judgment from funds derived from the state for performing its contractual obligations." *Id.*, (App. at 4a-5a), 381 F.3d at 441 n.8. Thus, the court held, NHIC could not claim Eleventh Amendment immunity as an arm of the State of Texas because (1) the State of Texas would neither be directly liable for a judgment nor required to indemnify NHIC for a judgment against it, and (2) the State would not be responsible for "NHIC's general debts and obligations." *Id.* (App. at 4a), 381 F.3d at 440.[8]

The Fifth Circuit's narrow indemnity-centered test squarely conflicts with this Court's Eleventh Amendment jurisprudence. In the public entity context, the Court has made clear that "the question whether a money judgment against a state instrumentality or official would be enforceable against the State is of considerable importance to any evaluation of the relationship between the State and the entity or individual being sued," *Regents*, 519 U.S. at 430, and that if a state is obligated to bear and pay the indebtedness of an entity whose

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8. In relying on these factors, the Fifth Circuit cited its decision in *Hudson v. City of New Orleans*, 174 F.3d 677 (5th Cir. 1999), where it held that the state treasury factor was determined by "first and most importantly, the state's liability in the event there is a judgment against the defendant, and second, the state's liability for the defendant's general debts and obligations." *Id.* at 687 (*citing Jacinoport Corp. v. Greater Baton Rouge Port Comm'n*, 762 F.2d 435, 441 (5th Cir. 1985)). Of course, the *Jacinoport* case on which *Hudson* relied predated this Court's decisions in *Regents of the University of California* and *Hess*, which substantially broadened the analysis of the state treasury test.

expenditures exceed its receipts, *either legally or practically*, the core concern of the Eleventh Amendment is implicated. *Hess*, 513 U.S. at 51. The Court also observed in *Regents* that "it is the entity's *potential legal liability*, rather than its ability or inability to require a third party to reimburse it, or discharge the liability in the first instance, that is relevant" for Eleventh Amendment purposes. *Regents*, 519 U.S. at 431 (emphasis added).

The Fifth Circuit's test defies the principles laid out by this Court that it is the state's potential liability, in a legal or practical sense, that matters, not the mere presence or absence of an indemnity agreement between a state and a private entity charged with carrying out traditional governmental functions. As currently formulated, the Fifth Circuit's test leads to the irrational conclusion that Relators can directly sue the fiscal intermediary of a state without running afoul of the Eleventh Amendment as long as the intermediary has agreed to indemnify the State for any resulting judgment.

The legal and practical impact of such a decision on the state treasury can hardly be overstated. The Texas Human Resources Code expressly allows the State to determine whether, as a financial matter, it is better off using its own staff to perform claims payment under the Texas Medicaid Program, or whether it should contract with an outside company such as NHIC to do so. TEX. HUM. RES. CODE ANN. § 32.029(b) (Vernon 1997). The Fifth Circuit's holding in this case – that a private corporation responsible for administering a traditional governmental program on behalf of the State is not entitled to immunity unless the State is obligated to pay a judgment against the entity – will deter private corporations from serving in such a role.

Indeed, if the Fifth Circuit's holding in this case is allowed to stand, private corporations such as NHIC will be nothing more than guarantors for the State's alleged misconduct, bearing risks out of proportion to any potential remuneration under the contract. The inevitable result is that a private entity will refuse to perform the State's administrative duties at all, or will charge the State a substantial premium for doing so. The State in turn may find itself administering the program, which would require the expenditure of additional state resources, or paying a private entity significantly more money to perform the same functions as those performed by NHIC under its contract with the State. In either event, it is clear that the orderly administration of the Texas Medicaid Program and the security of the state's treasury would be impacted if NHIC is not entitled to invoke the State's Eleventh Amendment immunity as an arm of the state.[9]

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9. Indeed, the Fifth Circuit's narrow test completely ignores the impact of a finding that the procedures the State required NHIC to follow were not in compliance with federal Medicaid guidelines. While the Department of Health and Human Services (and the Centers for Medicare and Medicaid Services ("CMS")) can audit states for compliance, *see, e.g.*, 42 C.F.R. § 430.33, if a court were to find that the State-mandated procedures NHIC followed were erroneous, the CMS might use such a finding in the administrative process to cut the funding of the Texas Medicaid Program. *See id.* §§ 430.35, 430.45. The impact of such efforts on the state fisc and the administration of Medicaid would be enormous. If Relators and the government wish to attack Texas' Medicaid procedures, they should follow the administrative process outlined in detail in the Code of Federal Regulations, so Texas will at least have the chance to defend its practices before having its funding impacted (and without being required to waive its immunity by intervening in this suit).

In addition to conflicting with decisions of this Court, the Fifth Circuit's indemnity test also conflicts with the tests adopted in other circuits. In *Shands*, for example, the Eleventh Circuit *refused* to limit its immunity analysis to the following facts, all of which are likewise present in this case: (1) the State was not a named party to the litigation; (2) the State was not required to indemnify the private contractor which was a party to the suit; and (3) the defendant private contractor was required to indemnify the State for any judgments against it arising out of the performance of its duties under its contract with the State. *Shands*, 208 F.3d at 1313. Instead, the court looked to the nature of the relationship between the private corporation and the State to determine whether the corporation was entitled to Eleventh Amendment immunity as an arm of the state:

> [u]nder the laws of Florida and the contractual provisions between the parties, it is clear that [the defendants] are simply administrators acting at the behest of the State with reference to Florida's health insurance program. The program is funded through annual legislative appropriations, and the State of Florida retains virtually complete control over the actions of its administrators.

Id. at 1311.

Thus, the Eleventh Circuit held that a declaratory judgment against the defendants in *Shands* would impermissibly implicate state funds and interfere with the administration of the state's health insurance program because the judgment "would ultimately affect the state treasury, insofar as the state insurance fund would be obligated to increase payouts on the number of covered

services," and "[a]ny analysis by the court of the State's obligations under the various contractual provisions would impermissibly intrude upon the future administration of the state program." *Id.* The court also held that the plaintiff's claim for damages based on the defendants' nonpayment of medical claims submitted by the plaintiff implicated state funds because the contract between the plaintiff and the defendants "provide[d] that the penalty for the failure to reimburse claims within thirty days is payment of the full amount of the claims. Such payment for medical services rendered is an obligation of the State." *Id.* at 1313. Accordingly, although the plaintiff only sought damages from the defendants, and not the state of Florida, the fact that the damages at issue were based on obligations of the state sufficiently implicated state funds to permit the private contractor to invoke the state's Eleventh Amendment immunity.

Since the decisions of this Court in *Hess* and *Regents*, other circuit courts in addition to the Eleventh Circuit have developed "state treasury" analyses that do not focus on the immediate, direct liabilities faced by states, but instead properly hinge on states' potential legal liabilities. For example, in *Ristow v. South Carolina Ports Authority*, 58 F.3d 1051 (4th Cir. 1995), *cert. denied*, 516 U.S. 987 (1995), an opinion issued after the Court remanded the case to the Fourth Circuit for decision in light of *Hess*, the court applied the state treasury factor with an emphasis on the *practical* effects of a judgment against an entity asserting arm of the state immunity. The court held that "[i]t is true that a judgment against the Ports Authority cannot be legally enforced against the state. The *practical effect* of South Carolina's treatment of the fiscal affairs of the Ports Authority, however, *definitively implicates* the state treasury."

Id. at 1054 (emphasis added). The court held that because the state "provides whatever economic support is necessary over and above the Port Authority's net revenues to insure its continued vitality," a "judgment against the Ports Authority involves the 'core concern' of the Eleventh Amendment – the ebb and flow of funds into and out of South Carolina's treasury." *Id.*

Instead of analyzing the extent to which the State of Texas could be exposed to any potential legal liabilities in connection with the administration of the Texas Medicaid Program or evaluating the extent to which the treasury would be affected either legally or practically as a result of a judgment against NHIC, the Fifth Circuit wrongly concluded that the only legal liability worth considering was an adverse judgment that the State itself would be required to pay. Because such a narrow test can only be said to focus on the state's *actual* liabilities, the court's decision conflicts with decisions of the Eleventh Circuit, the Fourth Circuit, and, most importantly, this Court. *See Regents*, 519 U.S. at 431; *Hess*, 513 U.S. at 51; *Shands*, 208 F.3d at 1311, 1313; *Ristow*, 58 F.3d at 1054.

The effect of the Fifth Circuit's test is that immunity will not lie even where, as here, all of the funding derives from the State, all of the activities are inherently governmental, the activities are wholly controlled by the State, and a judgment against the administrator of the State's Medicaid program would interfere with the administration of the program. The conflict between the circuits on this issue is one of paramount importance, and it merits resolution by this Court.

CONCLUSION

Petitioner respectfully requests that the Court issue a writ of certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit.

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